

***United States Court of Appeals
for the Second Circuit***



**APPELLEE'S REPLY
BRIEF**

74-1039

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-1039

GLEN-ARDEN COMMODITIES, INC., MILBANK TRADING CO., INC.,
ALBERT J. DEEB, JOSEPH LAMONICA, CHARLES LOFFMAN,
DAVID LOSEY, PATRICIA GALIOTO, DAVID LOEB,

Petitioners,

v.

MARK A. COSTANTINO, United States District Judge
for the Eastern District of New York,

Respondent.

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

GLEN-ARDEN COMMODITIES, INC., et al.,

Defendants.

On Petition for a Writ of Mandamus
to the United States District Court
for the Eastern District of New York

ANSWER OF SECURITIES AND EXCHANGE COMMISSION
TO PETITION FOR WRIT OF MANDAMUS TO THE
HONORABLE MARK A. COSTANTINO, D.J., AND
SUGGESTION OF MOOTNESS OF THE PETITION

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THE PROCEEDINGS BELOW

On August 23, 1973, the Commission commenced suit against
each of the petitioners herein in the United States District Court
for the Eastern District of New York. In that action the Commission

sought to enjoin petitioners ^{1/} from acts, practices and courses of conduct in violation of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, 15 U.S.C. 77e(a), 77e(c) and 77q(a), and Sections 10(b), 15(a) and 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), 78o(a) and 78o(b) and Rule 10b-5 thereunder, 17 CFR 240.10b-5. On the same day suit was commenced, or shortly thereafter, the Commission served petitioners with a motion for a preliminary injunction, returnable September 21, 1973. ^{2/} The Commission appended to its motion an extensive affidavit of a Commission attorney discussing the enterprise of defendants, 18 exhibits and a memorandum of law.

Thereafter, the defendants, on September 17, 1973, four days prior to the return date of the Commission's motion, served on the Commission, an order to show cause, signed by the court below on the application of petitioners, why the petitioners should not be allowed to file a motion to dismiss by October 10, 1973, which would be argued on November 7, 1973, and why the return date of the Commission's motion should not be vacated and held "in abeyance" pending hearing of petitioners' motion to dismiss. The court declined to sign the order insofar as it vacated the return date of September 21, for the Commission's motion. On September 19, 1973, the matter came on to be heard by the district court, at which time the Commission sought a temporary

1/ All of the defendants in the Commission's action for an injunction, except Philip Weinstein, are petitioners herein.

2/ The motion was not filed with the court until September 12, 1973.

restraining order and urged that an immediate evidentiary hearing be held on its motion for a preliminary injunction. The Commission's request for temporary relief was based on defendants' continuance of the conduct challenged by the complaint. The court set October 4, 1973, for oral argument on the petitioners' motion to dismiss for lack of subject matter jurisdiction and set October 12, 1973, for an evidentiary hearing, if required, on the Commission's motion for a preliminary injunction. The request for a temporary restraining order was denied. On October 3, 1973, in response to petitioners' motion to dismiss, the Commission cross-moved for partial summary judgment concerning its claim that defendants were offering and selling unregistered securities in violation of Section 5 of the Securities Act.

The matter came on to be heard by the court on October 4, 1973, at which time the Commission again urged a prompt and expeditious evidentiary hearing on all motions before the court and the defendants argued for a protracted briefing schedule and delayed oral argument on the motion to dismiss. The court reserved decision on the Commission's motion for partial summary judgment and the defendants' motion to dismiss; postponed the start of evidentiary hearings on all matters to November 15, 1973, and set October 25, 1973, for a pre-hearing conference. To accommodate counsel for petitioners, the pre-hearing conference was subsequently postponed to October 31, 1973. On October 29, 1973, defendants filed a motion returnable on November 7, 1973,

seeking to strike certain Commission affidavits. The court, during the pre-hearing conference held on October 31st, ruled on all matters raised by the defendants in their motion and expressly advised counsel that a full evidentiary hearing on all matters before the court would proceed on November 15, 1973. The defendants thereafter, in letters to the court dated November 2 and 9, 1973, urged reconsideration of the matters previously decided by the court and again urged an adjournment of the scheduled evidentiary hearing. Thereafter, on November 14, 1973, the defendants filed a notice of motion seeking to prevent the commencement of an evidentiary hearing pending the convening of a three-judge panel, among other reasons, to declare the term "investment contract" in the statutory definition of the term "security" in the federal securities laws void for vagueness, although this Court had previously ruled, in June 1973, that that argument was "untenable."^{3/} The district court on November 15, 1973, after oral argument, denied the defendants' motion to convene a three-judge panel and at defendants' request, allowed them 24 hours in which to appeal the decision. Thereafter, the defendants filed an application for a stay in this Court. This Court heard the matter on November 16, 1973, treated defendants' application as one for a writ of mandamus, and denied the application from the bench (No. 73-2699).

3/ Securities and Exchange Commission v. Brigadoon Scotch Distributors, Ltd., 480 F.2d 1047, 1052 (1973), certiorari pending, No. 73-677. One of the petitioners herein was a respondent in that case and all respondents were represented by present counsel for the petitioners. In that earlier petition, petitioners asked that the entire term "security" be declared void for vagueness.

Counsel for the petitioners, despite his appearance before the Court of Appeals on November 16, 1973, failed to appear that same day in the court below after this Court dismissed his application and the lower court was advised that counsel was ill. The district court, however, ordered the hearing to commence in the afternoon. At that time, defendants' counsel was present and the evidentiary hearing commenced. At the conclusion of that day's testimony, the Commission again sought a temporary restraining order against the petitioners which the Court issued after hearing oral argument. The temporary restraining order was granted for a period of eight days.

The evidentiary hearing continued on November 23, 1973, during which time extensive testimony was heard from investor witnesses and approximately forty documents were introduced into evidence. At the conclusion of the day's hearing, the Commission again sought a temporary restraining order which the court issued after hearing oral argument. Thereafter, the evidentiary hearing continued on November 30, 1973, December 10, 11, 17 and 18, 1973, during which time the Commission called additional witnesses and introduced numerous documents into evidence. By the conclusion of the hearing on December 18, 1973, almost 100 exhibits had been introduced into evidence and approximately 800 pages of testimony had been taken. During the hearing, the defendants presented little evidence, ^{4/} introduced no

^{4/} Appellants' brief on this appeal (at p. 18) describes their defense at trial as follows:

"Defendants' evidence took no more than two hours to present and consisted of the cross-examination of defendants Galimoto and Deeb, both of whom were witnesses called and examined by the SEC."

exhibits, and failed even to controvert many essential facts. Indeed, the defendant Albert Deeb, the defendants' only witness,^{5/} admitted to furnishing virtually all of the services which the Commission asserts caused the defendants' investments to be investment contracts within the meaning of Section 2(1) of the Securities Act of 1933 (see, e.g., pages 600-601, 605, 676-678, 788 of the trial transcript).

On December 18, 1973, after the completion of the hearing during which the petitioners had put in scant evidence, the court issued an order which is styled "Temporary Restraining Order." That order was to continue pending determination of the Commission's motion for injunctive relief. The order restrained defendants from, inter alia, selling or offering for sale securities in the form of scotch whisky warehouse receipts or any other securities of any other issuer, in violation of the registration and antifraud provisions of the Securities Act and of the Securities Exchange Act.

On January 10, 1974, petitioners filed this petition for mandamus and a notice of appeal from the order of December 18, 1973, and from prior temporary restraining orders which had already expired. The petitioners seek (a) an immediate stay by this Court of the restraining order then in effect; (b) prompt and expedited hearing of the issues presented by the petition; and (c) other relief which included a vacation of the restraining order and a prohibition against

^{5/} Although Deeb was called as a witness by the Commission, he remained on the stand after cross-examination by the Commission and was examined on direct by counsel for the petitioners (page 763 of the trial transcript).

issuance of similar orders pending issuance of "final judgment in this action in the district court below." The Court ordered the respondent to file an answer to the petition and scheduled oral argument on the petition and on the appeal for January 23, 1974.

The district court, on January 17, 1974, issued its opinion containing findings of fact and conclusions of law and on January 18, 1974, signed a preliminary injunction restraining defendants from violating Sections 5 and 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. Copies of the district court's opinion and preliminary injunction are appended hereto.

ARGUMENT

I. THE PETITION FOR A WRIT OF MANDAMUS IS MOOT

Petitioners seek to vacate the district court's temporary restraining order of December 18, 1973. That order, however, expressly provided that it would remain in effect only pending determination of the Commission's motion for a preliminary injunction. Since the district court has now granted the Commission's motion for a preliminary injunction and has filed such an injunction (together with its findings of fact and conclusions of law), the temporary restraining order has expired. Thus, the petition for a writ of mandamus to vacate the temporary restraining order is moot. Cf. Entin v. Stevens, 323 F.2d 894, 898 (C.A. 8, 1963). We are aware that petitioners have also requested in their petition that the district court be prohibited by this Court from entering any temporary injunctions, but this Court

can review whatever arguments petitioners make in support of this unusual request on an appeal from the preliminary injunction. The extraordinary writ of mandamus should not be resorted to as a mode of review where a statutory method of appeal has been prescribed or where an appealable order has been entered. Roche v. Evaporated Milk Assn., 319 U.S. 21, 27-28 (1943).^{6/} Petitioners' real quarrel now is with the district court's preliminary injunction of January 18, 1974, and the remedy is to file a notice of appeal from that injunction. The Commission, for its part, is most desirous that expedited treatment be afforded any such appeal. As our description of the proceedings in the district court makes evident (pp. 1-6, supra), petitioners have left no stone unearched in pursuing their dilatory and diversionary efforts to fend off a decision on the merits of the Commission's motion for preliminary injunctive relief. Now that the district court has rendered such a decision, the petitioners should seek prompt and expeditious review thereof.

II. PETITIONERS ARE NOT OTHERWISE ENTITLED
TO ANY RELIEF.

Petitioners argue that the order issued by the Court on December 18, 1973, which is no longer in effect, is invalid. The

^{6/} Nor may it be argued that the district court's temporary restraining order of December 18, 1973, is not moot because of the possibility that petitioners might, at some future time, be faced with an application to hold them in criminal contempt for violating that order while it was in effect. In such event, petitioners would not be able to raise as a defense the invalidity of the order, even if this Court were to entertain the present petition for a writ of mandamus and vacate the order, since willful violations of an order are punishable as a criminal contempt even though the order is later set aside on appeal. United States v. United Mine Workers, 330 U.S. 258, 293-95 (1947).

Commission concedes that if a temporary restraining order is extended, without the consent of the parties, "beyond the period of statutory authorization . . . [it has] the same practical effect as the issuance of a preliminary injunction, [and] is appealable" under 28 U.S.C.

1292(a)(1). Pan American World Airways, Inc. v. Flight Engineer International Ass'n., 306 F.2d 840, 843 (1962). The district court's order of December 18, 1973, would therefore be appealable as a preliminary injunction, had it not expired. Petitioners' arguments for vacating that order, however, are lacking in merit.

Petitioners' first argument for vacating the order is that it is not supported by findings of fact. That defect has now been cured with the district court's filing of findings of fact and conclusions of law. E.g., Gibbs v. Buck, 307 U.S. 66, 78 (1939); Johnson v. Heyd, 415 F.2d 1005, 1006 (C.A. 4, 1971).

Petitioners' second argument for vacating the order is that the district court had no power to issue any temporary relief so long as there was "substantial doubt" as to its jurisdiction (Petition for Mandamus, p. 16). Petitioners perceive the "jurisdictional issue" to be whether or not they are offering or selling "securities." Contrary to petitioners' argument, it is well settled that a court has jurisdiction to preserve the status quo and may issue such orders as are necessary to enable it effectively to determine the question of its own jurisdiction over the merits of the controversy. United States v. United Mine Workers of America, 330 U.S. 250, 290-293 (1947); United States v. Shipp, 203 U.S. 563 (1906). Moreover, petitioners wrongly

equate the finding of offers or sales of "securities" in this case with the existence of jurisdiction over the subject matter. Jurisdiction over the subject matter merely means that the court has the power to deal with the class of cases in which it renders judgment. 7 Moore, Federal Practice, ¶60.25[2] at page 302. The district court has jurisdiction over this action by virtue, inter alia, of Section 22(a) of the Securities Act, 15 U.S.C. 77v(a), which provides in part:

The district courts of the United States . . . shall have jurisdiction of offenses and violations under this title . . . and of all suits in equity . . . brought to enforce any liability or duty created by . . . [the Securities Act]." 7/

It is therefore evident that the instant case, brought to enforce liabilities and duties created by the Securities Act and the Securities Exchange Act, is within the class of cases which the district court may hear. The "jurisdictional" question posed by petitioners is merely an element of the claim which the Commission must establish in order to secure relief. The court, of course, had jurisdiction to decide that question in the context of determining whether the Commission was entitled to injunctive relief. And, as we shall discuss in our answering brief to petitioners' brief as appellants, the district court, on the merits, properly granted preliminary injunctive relief.

7/ The district court also has jurisdiction of the action under Section 27 of the Securities Exchange Act, 15 U.S.C. 78aa, which has substantially the same language as that in Section 22(a) of the Securities Act.

Petitioners also argue that the "status quo" was altered because they were not allowed to continue their activities (Petition for Mandamus, pp. 15-16). But those activities were challenged by the Commission as violations of the federal securities laws. Thus, petitioners' argument essentially amounts to nothing more than that the Commission can never obtain temporary relief of a prohibitory nature to restrain an ongoing violation of the law, since that would alter the status quo. If imposed, such a requirement would be at odds with the Supreme Court's directive that the courts "be alert to provide such remedies as are necessary to make effective the Congression¹ purpose." J. I. Case Co. v. Borak, 377 U.S., 426, 433 (1964).

Finally, petitioners argue that it was an abuse of discretion for the district court to hear any evidence of fraud (Petition for Mandamus, pp. 17-21). Petitioners argue that the court should only have heard evidence concerning the existence of a security. The court in its opinion stated that it "rejected this course" when it became clear that its jurisdiction was not in issue and that the evidence concerning the question of whether the defendants were selling securities within the meaning of the Securities Act would have been of necessity substantially the same as that which would have been presented on the issue of fraud. The court concluded (p. 5, n.2):

"No intelligent division of the evidence was discernible and furthermore, no legitimate reason was offered to justify what would have had to have been a wasteful and costly protraction of the proposed hearing."

The court can hardly be said to have abused its discretion. The simple fact is that the Commission's evidence both on the issue of whether defendants were offering and selling securities and on the issue of whether defendants were engaged in fraudulent practices was based upon the testimony of the same investor witnesses and the same offering literature and oral representations issuing from the defendants.

CONCLUSION

For the foregoing reasons the petition for mandamus should be dismissed.

Respectfully submitted,

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